CEO advisory

Leadership and strategy in the news

Craig Henry

Craig Henry, *Strategy & Leadership's* intrepid media explorer, collected these examples of novel strategic management concepts and practices and impending environmental discontinuity from various news media. A marketing and strategy consultant based in Carlisle, Pennsylvania, he welcomes your contributions and suggestions (craig_henry@centurylink.net).

Of strategies and strategists

Making diversification work

A company's operating model is central to its business model and, empirical evidence shows, a chief driver of performance. It's the sum total of the capabilities that enable the business to effectively and efficiently create, deliver, and capture value. The operating model is also a philosophy, a consistent set of management processes and practices that define how decisions get made and objectives are set.

A company can leverage a strong, cohesive operating model to manage and improve performance across a diversified portfolio of businesses. A familiar example is Danaher, a science and technology company with $18 billion in revenue from more than 25 operating companies in industries as diverse as diagnostics, life sciences, dental care, and environmental and applied solutions. While these businesses involve different products and serve diverse markets, they share a number of important characteristics. They offer small, medium-priced, performance-critical components of high-value systems that are difficult to substitute. Products are typically assembly-manufactured, with low customization and at medium volumes. The businesses are active in relatively small markets with high growth and low volatility, and with a fragmented customer base, which are less attractive for large, sophisticated competitors such as Siemens or General Electric.

The company's operating model, called the Danaher Business System (DBS), is consistently applied to all business units. It includes four components that support the broad objective of "helping realize life's potential":

People: A corporate talent funnel allows the company to carefully manage the development "journeys" of 2,000 high-potential employees through monthly reviews and extensive training in DBS principles and tool kits.

Plan: An annual strategic planning process focuses on challenging business units' management thinking and identifying five to seven strategic priorities for each business.

Process: A Kaizen-inspired continuous improvement process is supported by more than 50 tool kits, the DBS Office (which consists of about 20 members who rotate into the various businesses), and business unit experts.

Performance: The company translates strategic plans into specific targets, actions, and owners, and conducts monthly reviews of each unit's 15 KPIs. DBS measures performance in four areas: quality, delivery, cost, and innovation. Performance assessments are linked to the strategic plan, occur at frequent and regular intervals, and include objectives with varying time horizons.

The operating model creates value by emphasizing discipline and continuous improvement. This is particularly important for the Danaher

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businesses with high average gross margins. Unless well-managed, such margins have a habit of being self-destructive, as they tend to encourage lax management practices. Danaher also generates considerable value by applying DBS to newly acquired businesses. The company has repeatedly improved operating margins by seven percentage points or more in what were already high-margin businesses at the time of acquisition. For example, after Danaher's acquisition of Tektronix in 2007, its sales grew by 14.9% and margins increased to 15.8% in 2008.

Ulrich Pidun, Ansgar Richter, Monika Schommer, and Amit Karna, "A new playbook for diversified companies," *Sloan Management Review*, November 2018

Winning (and losing) by design

Despite the obvious commercial benefits of designing great products and services, consistently realizing this goal is notoriously hard–and getting harder. Only the very best designs now stand out from the crowd, given the rapid rise in consumer expectations driven by the likes of Amazon; instant access to global information and reviews; and the blurring of lines between hardware, software, and services. Companies need stronger design capabilities than ever before.

So how do companies deliver exceptional designs, launch after launch? What is design worth? To answer these questions, we have conducted what we believe to be (at the time of writing) the most extensive and rigorous research undertaken anywhere to study the design actions that leaders can make to unlock business value. . . .

In short, the potential for design-driven growth is enormous in both product- and service-based sectors. The good news is that there are more opportunities than ever to pursue user-centric, analytically informed design today. Customers can feed opinions back to companies (and to each other) in real time, allowing design to be measured by customers themselves–whether or not companies want to listen.

Lean start-ups have demonstrated how to make better decisions through prototyping and iterative learning. Vast repositories of user data and the advance of artificial intelligence (AI) have created powerful new sources of insights and unlocked the door for new techniques, such as computational design and analytics to value. Fast access to real customers is readily available through multiple channels, notably social media and smart devices. All of these developments should place the user at the heart of business decisions in a way that design leaders have long craved.

What our research demonstrates, however, is that many companies have been slow to catch up. Over 40 percent of the companies surveyed still aren't talking to their end users during development. Just over 50 percent admitted that they have no objective way to assess or set targets for the output of their design teams. With no clear way to link design to business health, senior leaders are often reluctant to divert scarce resources to design functions. That is problematic because many of the key drivers of the strong and consistent design environment identified in our research call for company-level decisions and investments.

Benedict Sheppard, Hugo Sarrazin, Garen Kouyoumjian, and Fabricio Dore, "The business value of design," *McKinsey Quarterly*, October 2018

When the perfect is the enemy of the good

It might make leaders feel very comfortable to believe that they can organize everything to their liking and plan for future revenue. It feels good to think, 'If we build resources, good things will happen' and 'If we have a long-term strategic plan, we have a good strategy'. But in my experience, that's not how it works.

The first thing to keep in mind about strategy is that it is not all that complex. You should keep it simple and always remember that, put simply, strategy is about choices.. . .

Strategy is not about perfection. It is not meant to be an analytical exercise that gets you the facts, so that once you've analyzed 'what is true', you just have to do X and you will be successful. Strategy is about the future, and the future is never going to be exactly the same as the past. That's why you've got to combine analytical rigor with creativity to get to the best possible answer. . ..

What you can do is imagine possibilities and make choices that you believe to be the most compelling you can make. Sometimes you will be right, and sometimes you will be wrong. That is the nature of strategy, because that is the nature of life. If you insist on perfect planning, you are deluding yourself into thinking that the future will be the same as the past. Sadly, in my experience, this is a mistake that many companies make.

Roger L. Martin, "The big lies of strategy," *Rotman Management,* Fall 2018

Model thinking and the single model trap

Organizations are awash in data – from geocoded transactional data to real-time website traffic to semantic quantifications of corporate annual reports. All these data and data sources only add value if put to use. And that typically means that the data is incorporated into a model. By a model, I mean a formal mathematical representation that can be applied to or calibrated to fit data.

Some organizations use models without knowing it. For example, a yield curve, which compares bonds with the same risk profile but different maturity dates, can be considered a model. A hiring rubric is also a kind of model. When you write down the features that make a job candidate worth hiring, you're creating a model that takes data about the candidate and turns it into a recommendation about whether or not to hire that person. Other organizations develop sophisticated models. Some of those models are structural and meant to capture reality. Other models mine data using tools from machine learning and artificial intelligence.

The most sophisticated organizations . . . use many models in combination. . . .

Though single models can perform well, ensembles of models work even better. That is why the best thinkers, the most accurate predictors, and the most effective design teams use ensembles of models. They are what I call, many-model thinkers. . . .

While applying one model is good, using many models – an ensemble – is even better, particularly in complex problem domains. Here's why: models simplify. So, no matter how much data a model embeds, it will always miss some relevant variable or leave out some interaction. Therefore, any model will be wrong.

With an ensemble of models, you can make up for the gaps in any one of the models. Constructing the best ensemble of models requires thought and effort. As it turns out, the most accurate ensembles of models do not consist of the highest performing individual models. You should not, therefore, run a horse race among candidate models and choose the four top finishers. Instead, you want to combine diverse models.

Scott E. Page, "Why 'many-model thinkers' make better decisions," *Harvard Business Review*, November 2018

Blue ocean strategy in action

Professor Kim noted that a fundamental aspect of Apple's success was embracing technologies developed by others. "In 1997, Apple didn't have the technology to break into the digital music market," he explained. "So how did they make the iPod? They partnered with tech companies. They did the same with the iPhone – partnering with companies that made touchscreens, as they knew that the touchscreen was the future of phones. So even though Apple didn't invent new technologies, they still managed to make big profits," he said.

Kim noted that technology innovation is not synonymous with growth. "Business is about making money by using technology; not about inventing new technologies," he said. "This is why growth relies on value innovation."

According to Kim, there is no such thing as a "bad industry". Even if the outlook for an industry looks bleak, opportunities exist – they just need to be unearthed. To do so, organizations need to "create, not compete," or shift from market competition to market creation. Kim explained that this requires companies to seek "blue oceans" of untapped markets instead of competing in "red oceans" of crowded, established marketplaces. "Don't compete within small boundaries or on existing customers. Instead, create new demand and attract noncustomers to grow your business," he advised.

"Why companies need to take a fresh look at innovation," *Blue Ocean Strategy,* 15 November 2018, available at: www.blueoceanstrategy.com/blog/why-companies-need-take-fresh-look-innovation/

Technology and disruption

What it takes to survive the "Fourth Industrial Revolution"

This Fourth Industrial Revolution carries with it seemingly limitless opportunity–and seemingly limitless options for technology investments. As organizations seek digital transformation, they should consider multiple questions to help narrow their choices: what, precisely, they hope to transform; where to invest their resources; and which advanced technologies can best serve their strategic needs. Further, digital transformation cannot happen in a vacuum; it does not end simply with implementing new technologies and letting them run. Rather, true digital transformation typically has profound implications for an organization–affecting strategy, talent, business models, and even the way the company is organized. . . .

Organizations are largely still finding a path that balances improving current operations with the opportunities afforded by Industry 4.0 technologies for innovation and business model transformation.

The strategy paradox. Nearly all respondents (94 percent) indicated that digital transformation is a top strategic objective for their organization. Just because respondents appear to understand its strategic importance, however, doesn't necessarily mean they are fully exploring the realm of strategic possibilities made possible by digital transformation. In fact, many fewer (68 percent) see it as an avenue for profitability.

The supply chain paradox. Executives identified the supply chain as a top area for both current and prospective digital transformation investments, indicating that supply chain initiatives are a top priority. However, supply chain executives and those outside of the C-suite who direct the actual day-to-day business operations–i.e., those with presumably the most “touch and feel” involvement with the implementation of digital technologies–do not appear to have a seat at the table when it comes to decisions about digital transformation investments.

The talent paradox. In keeping with Deloitte’s previous research on Industry 4.0,3 executives report feeling quite confident that they have the right talent in place to support digital transformations–but also seem to admit that talent poses a vexing challenge. Indeed, only 15 percent of respondents indicated they need to dramatically alter the composition and skill sets. At the same time, however, executives point to finding, training, and retaining the right talent as their top organizational and cultural challenge.

The innovation paradox. Executives report their digital transformation initiatives are driven largely by productivity improvement and operational goals–essentially, leveraging advanced technologies primarily to do the same things better. This finding has been borne out in previous Deloitte studies, suggesting a wider pattern around using advanced technologies for near-term business operations–at least initially–rather than truly transformative opportunities.

Around the physical-digital-physical loop. The ability to fully harness information from connected assets and use it to drive informed decisions is important to the full realization of Industry 4.0, and one which many organizations may not yet fully be able to execute in practice.

Tim Hanley, Andy Daecher, Mark Cotteleer, Brenna Sniderman, “The industry 4.0 paradox,” *Deloitte Insights*, available at: www2.deloitte.com/insights/us/en/focus/industry-4-0/challenges-on-path-to-digital-transformation/summary.html

Is it time to deal with market concentration?

Countries have acted to fuel competition before. At the start of the 20th century America broke up monopolies in railways and energy. After the second world war West Germany put the creation of competitive markets at the centre of its nation-building project. The establishment of the European single market, a project championed by Margaret Thatcher, prized open stale domestic markets to dynamic foreign firms. . ..

A similar transformation is needed today. Since 1997 market concentration has risen in two-thirds of American industries. A tenth of the economy is made up of industries in which four firms control more than two-thirds of the market. In a healthy economy you would expect profits to be competed down, but the free cash flow of companies is 76% above its 50-year average, relative to GDP. In Europe the trend is similar, if less extreme. . ..

Incumbents scoff at the idea that they have it easy. However consolidated markets become domestically, they argue, globalization keeps heating the furnace of competition. But in industries that are less exposed to trade, firms are making huge returns. We calculate the global pool of abnormal profits to be $660bn, more than two-thirds of which is made in America, one-third of that in technology firms (see Special report).

Not all these rents are obvious. Google and Facebook provide popular services at no cost to consumers. But through their grip on advertising, they subtly push up the costs of other firms. Several old-economy industries with high prices and fat profits lurk beneath the surface of commerce: credit cards, pharmaceutical distribution and credit-checking. When the public deals with oligopolists more directly, the problem is clearer. America’s sheltered airlines charge more than European peers and deliver worse service. Cable-TV firms are notorious for high prices: the average pay-tv customer in America is estimated to spend 44% more today than in 2011. In some cases public ire opens the door to newcomers, such as Netflix. . ..

Rising market power helps solve several economic puzzles. Despite low interest rates, firms have reinvested a stingy share of their bumper profits. This could be because barriers to competition keep out even well-funded newcomers. Next, since the turn of the millennium, and particularly in America, labor’s share of GDP has been falling. Monopolistic prices may have allowed powerful firms to eat away at the purchasing power of wages. The labor share has fallen fastest in industries with growing concentration. A third puzzle is that the number of new entrants has been falling and productivity growth has been weak. This may also be explained by a lack of competitive pressure to innovate.

“The next capitalist revolution,” *The Economist*, 15 November 2018

Industry focus

Retail the fall of giants

Sears Roebuck lost its forward momentum. It had powerful brand opportunities by virtue of Kenmore and Craftsman, and to a lesser extend Diehard. And these brands just stopped dead in the water because the product development efforts and the marketing investments in those brands were whittled down.

Sears always had a technical laboratory based in its headquarter facilities in Chicago. This is a facility that tested virtually all Sears private label products, and some branded products that the company intended to sell, to be sure that the products were safe. Remember, Sears sold everything from chainsaws to gas ranges to tractors. The company was devoted to being sure that any claims made about performance, features, and benefits were, in fact, substantiated. It was not an inexpensive group, because it was a fairly important team of engineers and testing professionals.

But one day, Lacy closed the lab because it gave him an opportunity to save $7 million a year in operating expense. Soon after Lacy made this decision, Sears discovered that they had started to sell a gas-fired kitchen range that was dangerous in that with enough weight put on the oven door – the ubiquitous 25-pound Thanksgiving turkey – the entire unit could tip. It's a small engineering feature that would have been caught in the lab. They had to recall everything that they had sold.

This is the kind of short-sighted stupidity that financial-based executives with no bigger sense of their responsibility make, to the eventual detriment of the organizations they lead.. . .

Mark Cohen, "Sears: a case study in business failure," *CSB Ideas at Work*, 23 October 2018, available at: www8.gsb.columbia.edu/articles/ideas-work/sears-case-study-business-failure

How to compete with Amazon

It's well known that Amazon has upended traditional retailers and steadily taken market share over the past two decades in categories such as general merchandise, furniture and apparel. Just as impressive, though, is how Amazon has redefined what consumers want from retailers. The company's dominance has actually changed which Elements of Value–fundamental benefits in their most essential, discrete and concrete forms–matter most to consumers in mass merchandising.

Over the past three years, elements such as reduces effort and avoids hassles have become more important catalysts for consumer loyalty in retail as measured by Net Promoter Score . Amazon delivers on these quite functional elements at a very high level, several consumer surveys by Bain & Company have shown. Its ascendance illustrates how some companies, as their innovative business models help them to expand their market share, can change what things really matter to consumers across a category.

No company is unbeatable, however. One powerful disrupter may change the rules of the game, but some rivals eventually figure out how to adapt by playing the game better or shifting the rules yet again.

Consider how Chewy has more than held its own against Amazon in one major e-commerce category, pet food and supplies. Since its founding in 2011, Chewy has emphasized customer service and a massive selection of products at affordable prices. And the company convinced manufacturers of premium products, which historically restricted their distribution only to independent pet stores, to supply it with their choice merchandise, thereby expanding its offerings.

Throughout its evolution, Chewy has chosen to focus on functional Elements of Value such as variety, saves time, reduces effort and reduces cost. Today, Chewy delivers on the same eight elements in pet supplies as Amazon does, but, impressively, it outperforms Amazon on six of those eight elements. Chewy worked deliberately on these elements by, for example, moving warehouse fulfillment in-house and building fulfillment centers around the country, and by adding a full-service online pet pharmacy. By figuring out which elements matter to pet owners and performing well on those elements, Chewy has realized outsized growth. Revenue has risen at an 89% compound annual growth rate from 2013 through 2017, and the company's share of the online pet supplies market rose from 8% to 26%.

Eric Almquist, Grace Wynn, Jamie Cleghorn and Lori Sherer, "Delivering what consumers really value," *Bain Insights,* 10 October 2018, available at: www.bain.com/insights/delivering-what-consumers-really-value

How to turn failure into success

All of my firm's projects bring together diverse teams to try to make progress on complex and contentious public issues. No single party controls the outcome, and we can't know in advance what will work, so things often unfold differently than planned. Through these experiences, I've come to view unexpected results not as a problem but as a spur for the learning and adaptation we need to do. Improvisation, therefore, is a sign not of failure, but of success. There are structured ways to improvise, though, that will help ensure big bumps in the road don't throw you completely off course.

Look forward, not backward. You may not always do things right the first time, but you should be intent on learning from what happened and doing better next time. At the end of every unit of my work – every quarter, project phase, or workshop day – the team sits down for a "plus/delta" meeting in which everyone gives an answer to two questions about themselves, their colleagues, and the whole team:

Plus: "What did I/you/we do well that I/you/we need to keep doing?"

Delta (the mathematical symbol for change): "What do I/you/we need to do better next time?"

We did this at the end of the second day of the meeting in Mexico, and it's how we discovered a new and better way forward.

I've come to view unexpected results not as a problem but as a spur for the learning and adaptation we need to do.

The delta question should not be focused on what you did wrong, because you'll rarely have the opportunity for do-overs; it should look ahead at what you need to do differently. Most of the time, self-assessments and assessments by others will be congruent and not require much discussion. Sometimes, though, perceptions will differ, and the group will have to work through this to decide what to do next. Try not to make the same mistakes twice.

Adam Kahane, "How to fail successfully," *S+B blogs*, 20 November 2018, available at: www.strategy-business.com/blog/How-to-Fail-Successfully

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